Only about one-fourth of this huge category of spending is means-tested--that is, paid to people who must document their need based on income or assets (and often other criteria, such as family status). Among the means-tested programs are the two fastest-growing entitlements, Medicaid and the earned income tax credit (EITC). But the remainder, led by the government's big retirement-related programs, are not means-tested and account for most of the growth in dollar terms.

Means-Tested Programs. Medicaid, the joint federal and state program providing medical care to some of the poor, makes up about half of means-tested entitlements. CBO projects that federal outlays for Medicaid will reach $151 billion by 1999, double the figure for 1993 (see Table 2-6). In that year, the states' share is expected to be another $114 billion.

The annual growth in Medicaid spending zoomed to between 20 percent and 30 percent in 1990 through 1992 but decelerated to 12 percent in 1993. The extraordinarily fast growth was fueled by population and cost pressures, liberalizations in Medicaid eligibility contained in legislation (especially coverage of poor children), the recession, and the fiscal pressures facing state and local governments that drove them to maximize funds from the federal government. In particular, the federal share of direct payments to hospitals that serve many charity cases (the so-called disproportionate share hospitals) soared from practically nothing in 1989 to almost $10 billion in 1992 before dipping to an estimated $9 billion in 1993.

Although Medicaid is the biggest and fastest-growing of the means-tested programs, several others in this cluster are also experiencing rapid growth. Prominent among them are food stamps, which are available to virtually all who qualify on the basis of low income and assets regardless of age or family status (and which now are paid to one-quarter more people than in mid-1990); Supplemental Security Income for the aged, blind, and disabled, which has seen its caseload of disabled participants climb steeply; and the refundable portion of the earned income tax credit. Traditionally a supplement to the earnings of low-income families with children, the EITC was made more generous in last year's reconciliation act and broadened to cover some childless people. Although the EITC is a provision of the tax code, direct EITC payments to recipients who otherwise owe no taxes are treated as outlays since they are tantamount to benefit payments.

Non-Means-Tested Programs. Social Security, Medicare, and other retirement and disability programs dominate non-means-tested entitlements. In fact, a milestone of sorts was passed in 1993; Social Security overtook the defense budget as the government's single biggest spending program. Most Social Security beneficiaries, who now number 42 million, also participate in Medicare. The Medicare population is somewhat smaller than Social Security's, however, for several reasons: retirees can collect Social Security beginning at age 62 but must wait until age 65 for Medicare; younger beneficiaries who are awarded disability benefits face a two-year wait before qualifying for Medicare; and many spouses and most children of Social Security beneficiaries qualify for cash benefits but not medical benefits.

Although Social Security is the larger program, Medicare has grown much faster despite repeated efforts to rein in its costs. Over the past decade, Medicare grew by an average of 10 percent a year versus Social Security's 6 percent, and similar growth rates are projected for the next five years. Only a fraction of the two programs' growth is explained by their caseloads; beneficiary populations generally grow between 1 percent and 2 percent a year. The remainder is accounted for by greater benefits per enrollee, fueled--in the case of Medicare--by high medical care inflation, advances in expensive technology, and greater use of covered services.

Other retirement and disability programs together are less than one-fourth the size of Social Security. They are dominated by benefits for the federal government's civilian and military retirees and Railroad Retirement.

Unemployment compensation is one of the few entitlement programs expected to shrink under current law in the next few years. The unemployment rate gradually declines, and the temporary

Table 2-6.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance (By fiscal year, in billions of dollars)

	Actual 1993	1994	1995	1996	1997	1998	1999
			Means-Tested Programs				
Medicaid	76	86	·96	108	121	135	151
Food Stamps[a]	25	25	26	26	28	29	30
Supplemental Security Income	21	25	24	24	29	32	35
Family Support	16	17	18	18	19	19	20
Veterans' Pensions	4	3	3	3	3	3	3
Child Nutrition	7	7	7	8	8	9	9
Earned Income Tax Credit	9	11	15	18	20	21	22
Student Loans	2	2	2	2	1	1	2
Other	3	3	3	4	4	4	5
Total, Means-Tested Programs	162	179	195	211	233	254	276
			Non-Means-Tested Programs				
Social Security	302	318	335	352	370	388	408
Medicare	143	160	177	195	215	238	264
Subtotal	445	478	512	547	585	626	672
Other Retirement and Disability							
Federal civilian[b]	39	40	42	43	46	48	51
Military	26	26	27	29	30	32	35
Other	4	5	5	5	5	5	5
Subtotal	69	71	74	77	81	85	90
Unemployment Compensation	35	27	24	25	25	26	26
Other Programs							
Veterans' benefits[c]	17	18	17	16	18	18	19
Farm price supports	16	11	7	8	8	8	9
Social services	5	6	6	6	6	6	5
Credit reform liquidating accounts	2	2	-1	-8	-4	-5	-6
Other	10	12	9	8	8	9	8
Subtotal	49	48	38	30	36	36	35
Total, Non-Means-Tested Programs	599	624	649	679	727	773	823
			Total				
All Mandatory Spending, Excluding Deposit Insurance	761	803	844	890	960	1,026	1,099

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.

c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

extensions of benefits that helped to push total spending above $35 billion in both 1992 and 1993 are slated to expire.

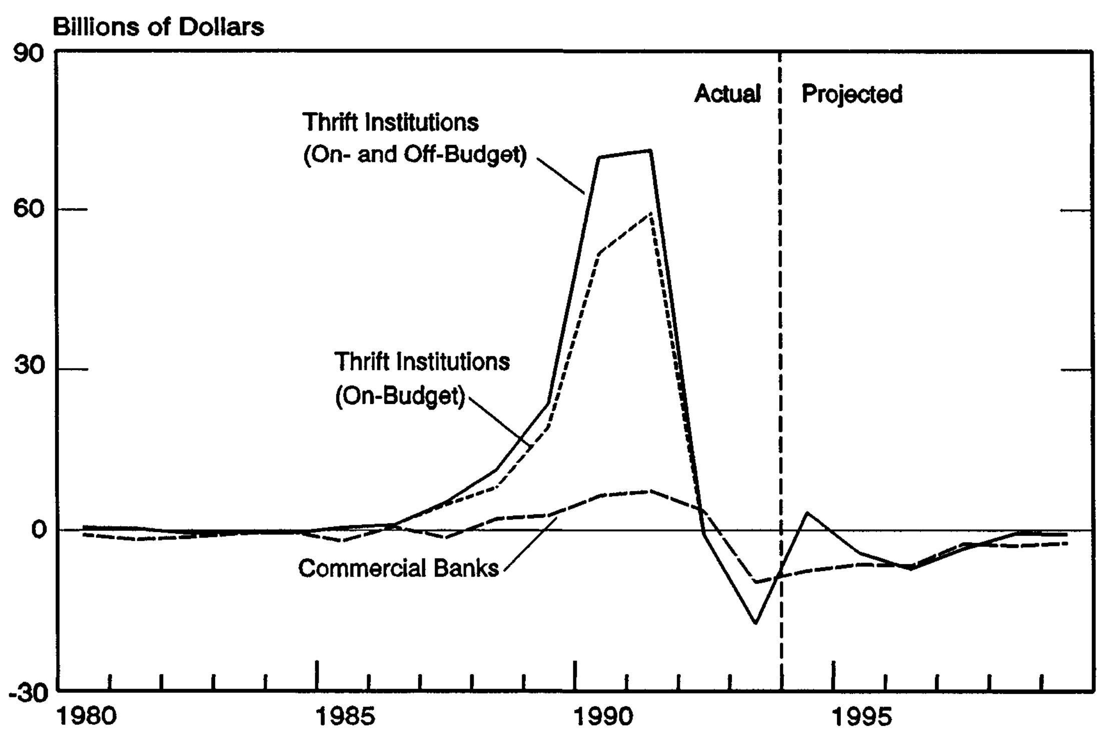
Other non-means-tested entitlements encompass a diverse set of programs, mainly veterans' benefits, farm price supports, and certain social service grants to the states. In aggregate, this category totals $48 billion in 1994. It shrinks by a third by 1999, mirroring the decline of two of its components--farm price supports and the liquidating accounts set up to reflect cash flows from loans obligated before 1992 when credit reform took effect.

Deposit Insurance

Deposit insurance contributed little to the spending totals before the late 1980s, as premiums paid by financial institutions and other income to the deposit insurance funds (such as interest and proceeds from liquidations of assets) roughly equaled the costs of covering failed institutions. This pattern held fairly true even in the early 1980s, when savings and loan institutions--then hamstrung by restrictions on their investments and on the interest they could pay to depositors--faced big losses.

But choices made in the wake of that first crisis to relax regulation and to postpone shutdowns of troubled institutions proved to be costly. Deposit insurance outlays shot up to a record $66 billion in 1991 (see Figure 2-3). They skidded to $3 billion in 1992, and the agencies actually recorded negative outlays (that is, net receipts) of $28 billion in 1993, indicating that their income from liquidations and other sources far exceeded their disbursements. Not surprisingly, this extraordinarily volatile category of

Figure 2-3.
Deposit Insurance Spending (By fiscal year)



SOURCE: Congressional Budget Office.

NOTE: Off-budget outlays for thrift institutions refer to the net borrowing of the Financing Corporation and the Resolution Funding Corporation, government-sponsored enterprises set up exclusively to borrow funds to pay for resolutions of failed savings and loan institutions.

spending has been one of the biggest sources of uncertainty in Congressional budget projections over the past few years (see Appendix B). CBO expects that this category will continue to record net negative outlays, as documented in Table 2-7.

Savings and Loan Institutions. The savings and loan cleanup is forging ahead after a prolonged interruption in its funding. From April 1992 until December 1993, the Resolution Trust Corporation (RTC) had only very limited authority to incur losses. It was largely confined to selling off its portfolio of assets and to resolving the occasional institution that could be closed or merged at little or no loss to the government; hence, the RTC recorded negative outlays in both 1992 and 1993.

The Congress brought this drought to an end in late 1993 with the Resolution Trust Corporation Completion Act. The act empowered the RTC to incur up to $18.3 billion in further losses simply by lifting a deadline of April 1, 1992, on the RTC's ability to commit funds that had been approved in December 1991. Sometime between January and June 1995, the RTC will hand over the responsibility for covering future failures to the Savings Association Insurance Fund (SAIF).

As sanctioned by the Budget Enforcement Act, CBO did not treat this final batch of RTC money as an entry on the pay-as-you-go scorecard. The BEA explicitly provides that any funding that enables the government to carry out its existing deposit insurance commitments, but does not broaden that commitment, does not demand a tax increase or an offsetting cut in another program. Echoing most economists and participants in financial markets, the BEA's drafters presumably reasoned that the true loss to taxpayers occurred sometime in the past, when high-flying institutions racked up the losses that the government now is obliged to cover. Belatedly recognizing these losses, and providing the dollars needed to cover them, amounts to a transfer of existing assets and liabilities; it does not make depositors richer or spur the economy, as other deficit-raising actions would. The national income and product accounts, which provide macroeconomists with another framework for describing the government's role in the economy, have always excluded the bulk of deposit insurance spending and similar transactions that lack current economic effects (see Appendix D).

There is good news on the RTC front: the agency will not fulfill the gloomy predictions that were common even a year or two ago. CBO now estimates the total value of losses covered by the RTC since its inception in 1989 at about $90 billion (expressed, by convention, in 1990 dollars). Such calculations exclude disbursements for working capital--funds that the government needs temporarily when it acquires troubled institutions but ultimately recoups when assets are sold. Together with about $60 billion in losses covered by the Federal Savings and Loan Insurance Corporation and its successor, the FSLIC Resolution Fund--the fund charged with resolving institutions already in government hands before the RTC's creation--the total cost of the cleanup comes to $150 billion.

Three and a half years ago, CBO feared that the RTC's costs alone could be as high as $185 billion. (The Bush Administration, in its initial proposal to establish the RTC, said that $50 billion would be sufficient.) The extraordinarily favorable environment for interest rates in the past few years deserves part of the credit for the turnaround. Legislation passed after the RTC's creation further tightened regulatory procedures and required financial institutions to bolster their levels of capital. And the industry's shrinkage has eased conditions for survivors. There are now about 1,700 institutions with $0.8 trillion in gross assets, down from 3,000 institutions with $1.3 trillion in assets in 1988, with most of the worst money-losers and hence most recklessly managed institutions purged. About 10 percent of the current industry, as measured by assets, remains troubled and could end up in RTC or SAIF hands, though it is unlikely to saddle the government with huge costs.

Is SAIF sound? In passing the last installment of RTC funding, policymakers provided no assured funding for SAIF. Rather, they authorized $8 billion, subject to future appropriation, and stipulated that the Federal Deposit Insurance Corporation would first need to certify that conditions in the industry required using taxpayer funds. SAIF held reserves of just over $1 billion at the end of 1993, and under CBO's projections, its reserves will not meet their

Table 2-7.
CBO Baseline Projections for Deposit Insurance (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
			Savings-and-Loan-Related			
Resolution Trust Corporation and Savings Association Insurance Fund						
Insurance losses[a]	12	3	1	1	1	1
Working capital						
Disbursements	8	4	1	1	1	1
Receipts	-17	-12	-9	-5	-2	-2
Interest costs	1	1	1	b	b	b
Insurance premiums	-1	-1	-1	-1	-1	-1
Total	2	-5	-7	-3	-1	-1
FSLIC Resolution Fund	1	1	0	0	0	0
			Bank-Related and Other			
Bank Insurance Fund						
Losses	1	2	2	2	2	2
Working capital disbursements	3	4	4	4	4	4
Liquidations	-7	-6	-5	-5	-5	-5
Net interest	b	-1	-1	-1	-1	-1
Other outlays (net)	-5	-6	-6	-1	-2	-2
Total	-8	-6	-7	-3	-3	-3
Other[c]	b	b	b	b	b	b
			Total			
Total Deposit Insurance	-5	-11	-14	-6	-4	-4

SOURCE: Congressional Budget Office.

NOTE: The Resolution Trust Corporation is currently scheduled to stop accepting new cases sometime in early 1995 and turn over responsibility for future resolutions to the Savings Association Insurance Fund.

a. Includes less than $500 million per year in administrative costs.

b. Less than $500 million.

c. Primarily activities of the National Credit Union Administration.

statutory target anytime during the five-year projection period. Indeed, although SAIF's resources appear sufficient to handle the volume of failures that CBO now projects, they are too thin to withstand many nasty surprises, such as unexpectedly large failures combined with a greater-than-expected erosion in thrift institutions' deposit base. This deterioration, which would cause premium income to the fund to wither, could accelerate if--as CBO expects--thrift insitutions are made to pay higher premium rates for deposit insurance than are commercial banks.

Commercial Banks. Recent anxiety about the condition of commercial banks has abated. The government's fund for insuring commercial banks incurred positive outlays in 1988 though 1992 but is now back in the black. The Bank Insurance Fund (BIF) is actually expected to take in $8 billion more than it spends in 1994, with a smaller excess in later years (see Table 2-7). As a result, BIF's reserves are expected to be robust enough in 1997 that CBO estimates that the fund's premium rates will then drop by two-thirds, as permitted by law.

Offsetting Receipts

Offsetting receipts are income that the government records as negative spending. All are either intragovernmental (reflecting payments from one part of the federal government to another) or proprietary (reflecting voluntary payments from the public). Because they do not stem from the government's taxing power, they are traditionally recorded as negative spending rather than on the revenue side of the books.

A decision to collect more (or less) in offsetting receipts usually requires a change in the underlying laws generating such collections. Thus, offsetting receipts are more like mandatory spending and revenues than like discretionary appropriations; and, like the former, they are subject to the pay-as-you-go discipline.

About one-half of offsetting receipts are intrabudgetary transfers that represent agencies' contributions for their employees' retirement (see Table 2-8). Failing to charge agencies for these costs would clearly let them understate their personnel costs, as future retirement benefits are an important part of compensation for current federal workers. To avoid such a perverse result, the budget treats the payments as part of agency budgets, and the deposits in retirement funds (principally Social Security, Military Retirement, and Civil Service Retirement) as offsetting receipts. These two transactions thus wash out in the budgetary totals, leaving only actual payments to the public--for benefits and administrative costs--reflected in total outlays.

Voluntary Medicare premiums collected from the elderly and disabled grow from an estimated $17 billion in 1994 to $27 billion in 1999, as the monthly premium climbs from $41.10 now to an estimated $56.30 in 1999. Last year's reconciliation act reimposed the requirement that premiums cover one-quarter of the costs of Supplementary Medical Insurance (Part B of Medicare, the portion that covers physician and outpatient charges). That requirement, however, expires after 1998, and premiums will revert to growing only in tandem with the cost-of-living increase in Social Security. Other offsetting receipts come mostly from charges for energy, minerals, and timber and various fees levied on users of government property or services.[4]

Not included in the offsetting receipts category are offsetting collections. These collections (such as deposit insurance premiums) are traditionally counted as offsets within spending programs; thus, the programs for which they are earmarked are simply recorded on a net basis in the budget.

Net Interest

Net interest costs are expected to be about $200 billion in 1994 for the fourth year in a row. This stability is astonishing in light of the fact that the government will have added about $1 trillion in debt over the four-year period. The government has saved handsomely by refinancing its maturing debt at lower interest rates. This gain is not evanescent; interest rates today remain near record-low levels and

4. For a discussion of trends in federal user charges and similar collections, see Congressional Budget Office, *The Growth of Federal User Charges* (August 1993).

Table 2-8.
CBO Baseline Projections for Offsetting Receipts (By fiscal year, in billions of dollars)

Category	Actual 1993	1994	1995	1996	1997	1998	1999
Employer Share of Employee Retirement							
Social Security	-6	-6	-7	-7	-8	-8	-9
Military Retirement	-13	-13	-12	-12	-12	-12	-12
Other[a]	-15	-16	-17	-17	-18	-20	-21
Subtotal	-35	-35	-36	-37	-38	-40	-42
Medicare Premiums	-15	-17	-20	-20	-22	-26	-27
Energy-Related Receipts[b]	-5	-4	-5	-4	-4	-4	-4
Natural-Resource-Related Receipts[c]	-3	-3	-3	-3	-3	-3	-3
Electromagnetic Spectrum Auctions	0	-1	-5	-1	d	d	d
Other	-10	-9	-9	-9	-9	-9	-9
Total	-67	-69	-77	-74	-78	-83	-86

SOURCE: Congressional Budget Office.

a. Primarily Civil Service Retirement.

b. Includes proceeds from sales of power, various fees, and receipts from the naval petroleum reserves and Outer Continental Shelf.

c. Includes timber and mineral receipts and various user fees.

d. Less than $500 million.

are not expected to shoot up over the 1995-1999 period.

Despite today's low interest rates, net interest costs are about 3 percent of GDP--two to three times the typical levels of the 1960s and 1970s. Their growth is clearly traceable to the vastly bigger federal debt.

Interest costs generally are not governed by provisions of the Budget Enforcement Act because they are not directly controllable. Rather, interest depends on the government's debt and on interest rates. The Congress and the President influence the former by making decisions about taxes and spending and hence about borrowing. They exert no direct control over interest rates, which are determined by market forces and Federal Reserve policy.

The importance of interest rates is illustrated in Appendix C. If interest rates are 1 percentage point higher in 1994 through 1999 than CBO assumes, net interest costs will be greater--by about $5 billion in 1994 and $42 billion in 1999. A recent shift by the Treasury Department to borrow more short-term and less long-term debt is expected to save money but will slightly increase the govern-ment's vulnerability to fluctuations in interest rates. This effect is only marginal, however; with or without the shift, the government faced large amounts of financing and refinancing that had to be handled at prevailing market rates.[5]

5. Congressional Budget Office, *Federal Debt and Interest Costs* (May 1993).

CBO projects that net interest costs will climb gradually to $261 billion in 1999 (see Table 2-9). The growth in debt is the main fuel; debt held by the public (bills, notes, bonds, and other securities sold to raise cash) is expected to mount from $3.2 trillion at the end of 1993 to $4.4 trillion in 1999. And rising interest rates, chiefly on short-term instruments such as Treasury bills, push up spending modestly.

Net or Gross? Some budget-watchers like to use gross interest (and its counterpart, the gross federal debt) instead of net interest (and its counterpart, debt held by the public). But this choice exaggerates the government's debt-service burden because it overlooks billions of dollars in interest income received by the government.

The government has sold trillions of dollars of securities to finance the deficit. But it also issues securities to its own trust funds (mainly Social Security and the other retirement funds) and both pays and collects the interest thereon; it also receives interest income from loans and cash balances. Broadly speaking, *gross interest* encompasses all interest paid by the government (even to itself) and ignores all interest income. *Net interest*, in contrast, is the net flow to recipients outside government.

In 1994, net interest is only two-thirds as big as gross interest. CBO estimates that the government will pay $298 billion in gross interest costs. Of that amount, however, $88 billion is simply credited to trust funds and does not leave the government or add to the deficit. And the government collects $10 billion in other interest income. Net interest costs therefore total $201 billion. The burden of interest costs, which represent money siphoned from current needs to pay past bills, is amply documented by using net interest.

Debt Subject to Limit. The Congress sets a limit on the issuance of public, or Treasury, debt. This limit applies to securities issued to federal trust funds as well as those sold to the public. Hence, it is practically identical to the gross federal debt--and probably explains why this figure, though less useful than debt held by the public, is more familiar. (The minor differences between gross debt and debt subject to limit are chiefly attributable to securities issued by agencies other than the Treasury, such as the Tennessee Valley Authority, which are exempt from the limit.)

As part of last summer's deficit reduction package, the Congress raised the limit on public debt to $4.9 trillion. CBO expects debt subject to limit to reach $4,958 billion by the end of fiscal year 1995, suggesting that the limit will have to be raised sometime in the preceding spring or summer (see Table 2-9).

The Revenue Outlook

Federal revenues are expected to be $1.25 trillion in 1994, or 18.8 percent of GDP. They are projected to grow only a little faster than the economy in the next five years, reaching 19 percent of GDP in 1999. As a share of GDP, revenues will be slightly higher than typical levels of the past three decades. In 1960 through 1993, revenues averaged 18.6 percent of GDP. In only a few years did they reach or top 19 percent: in 1969 and 1970 (when taxes were hiked to help finance the Vietnam War); in 1979 through 1982 (years of high inflation, which preceded the Reagan Administration's tax cut and the accompanying indexing of income tax brackets to inflation); in 1987 (when taxpayers rushed to realize capital gains before tax reform, which repealed preferential rates on such income, took effect); and in 1989 (when final payments from the first full year of tax reform flowed in and the economy was still chugging along strongly).

But in an echo of the outlay story, underneath this overall stability of the revenue-to-GDP ratio are some substantial shifts in composition (see Figure 2-4). The most striking shift is the government's increasing reliance on social insurance contributions (now about 7 percent of GDP) and its diminishing reliance on corporate income taxes and excise taxes (now about 2 percent and 1 percent of GDP, respectively). Individual income taxes, the biggest contributor to government coffers, have mostly fluctuated in the range of 8 percent to 9 percent of GDP.

Table 2-9.
CBO Baseline Projections for Interest Costs and Federal Debt (By fiscal year)

	Actual 1993	1994	1995	1996	1997	1998	1999
Net Interest Outlays (Billions of dollars)							
Interest on Public Debt (Gross interest)[a]	293	298	311	330	346	363	382
Interest Received by Trust Funds							
Social Security	-27	-30	-34	-37	-42	-47	-52
Other trust funds[b]	-55	-57	-56	-57	-58	-60	-61
Total	-82	-88	-89	-94	-100	-106	-114
Other Interest[c]	-11	-10	-10	- 9	-8	-8	-8
Total, Net Interest Outlays	199	201	212	228	239	249	261
Federal Debt, End of Year (Billions of dollars)							
Gross Federal Debt	4,352	4,690	4,995	5,314	5,656	6,003	6,375
Debt Held by Government Accounts							
Social Security	366	428	498	574	658	750	850
Other government accounts[b]	739	800	855	918	977	1,035	1,085
Total	1,105	1,228	1,353	1,492	1,635	1,785	1,934
Debt Held by the Public	3,247	3,462	3,642	3,822	4,021	4,218	4,441
Debt Subject to Limit[d]	4,316	4,653	4,958	5,275	5,616	5,963	6,334
Federal Debt as a Percentage of GDP							
Debt Held by the Public	51.6	52.2	52.0	51.7	51.7	51.5	51.7

SOURCE: Congressional Budget Office.

NOTE: Projections of interest and debt assume compliance with the discretionary spending caps in the Budget Enforcement Act.

a. Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).

b. Principally Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Highway and the Airport and Airway trust funds.

c. Primarily interest on loans to the public and to the Resolution Trust Corporation and the Bank Insurance Fund.

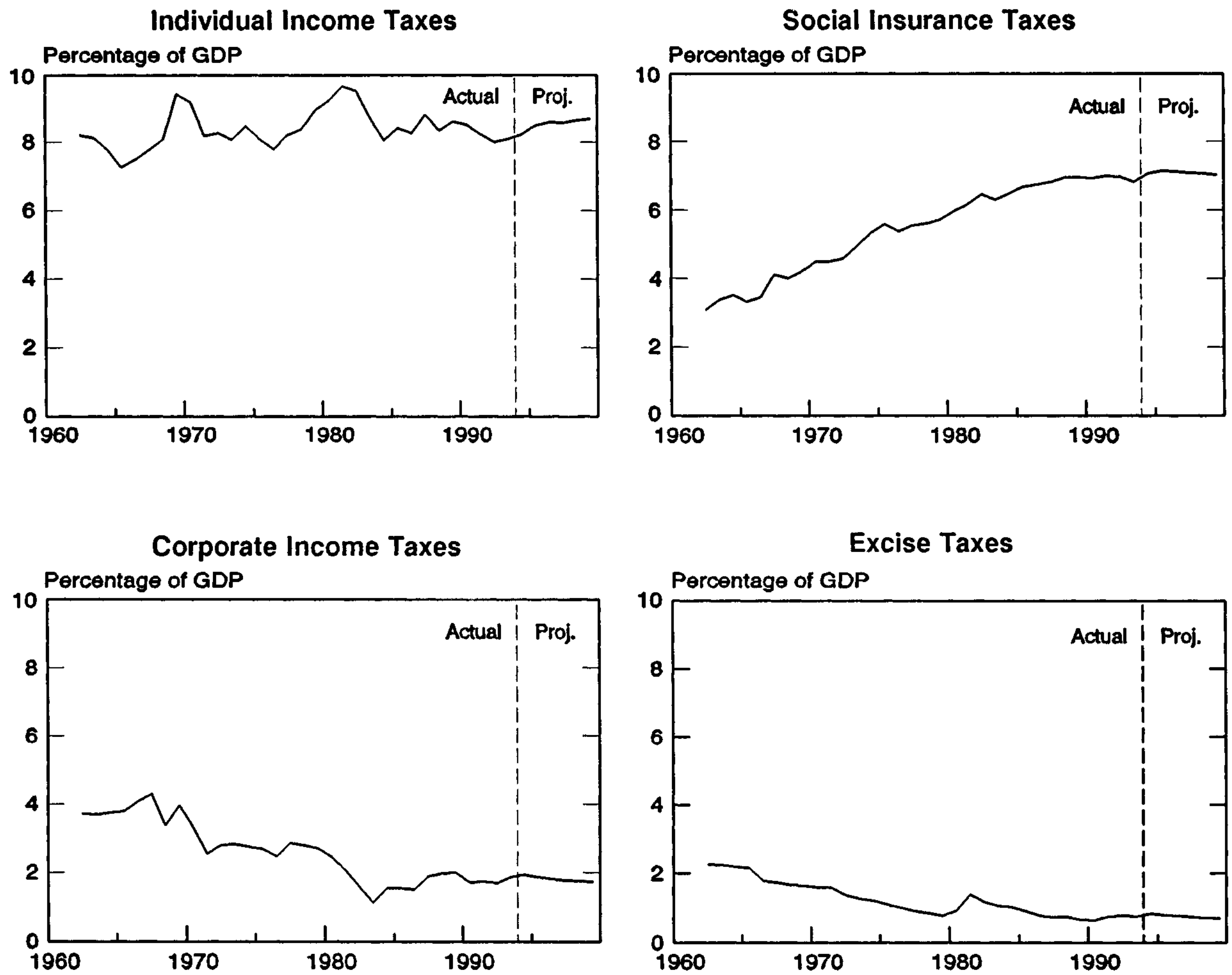
d. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit.

Baseline Projections

In the baseline, individual income taxes are the only revenue source that is expected to grow even modestly as a share of GDP, from 8.2 percent in 1994 to 8.7 percent in 1999 (see Table 2-10). Over half of the revenue increases contained in last summer's reconciliation act will appear in this category--chiefly the increase in tax rates for high-income individuals and the increase in the portion of Social Security benefits subject to income tax.

Social insurance taxes hang on to their share of GDP in the projections. Such taxes are expected to total 7.1 percent of GDP in 1994 through 1998 and 7 percent in 1999--up from 6.8 percent in 1993. OBRA-93 boosted social insurance collections by an average of $7 billion a year, mainly by repealing the cap on earnings subject to the Medicare tax. But federal unemployment taxes are nevertheless expected to slip as a share of GDP under current law as the economy recovers and the unemployment trust fund is replenished, permitting states to reduce their tax rates.

Figure 2-4.
Revenues by Source as a Share of GDP



SOURCE: Congressional Budget Office.

Even though the reconciliation act increased taxes on corporations, the corporate income tax is nevertheless expected to drift down from 1.9 percent of GDP in 1994 to 1.7 percent in 1999, mirroring a decline in corporate profits as a share of GDP. Similarly, excise taxes--which were bolstered by increases in taxes on transportation fuels and by other provisions of OBRA-93--slip marginally as a share of GDP, mainly because most excise taxes are fixed in dollar rather than in percentage terms.

Expiring Provisions

CBO's baseline projections for revenues assume that current tax law remains unchanged. The projections take into account that some provisions are scheduled to change or expire during the 1994-1999 period. The baseline assumes that these changes and expirations occur on schedule. One category of taxes--excise taxes dedicated to trust funds--constitutes the sole exception to this rule. CBO assumes that these

Table 2-10.
CBO Baseline Projections for Revenues, by Source (By fiscal year)

Source	Actual 1993	1994	1995	1996	1997	1998	1999
			In Billions of Dollars				
Individual Income	510	547	596	635	668	708	748
Corporate Income	118	128	130	133	138	144	148
Social Insurance	428	468	499	526	551	578	604
Excise	48	55	56	57	58	59	60
Estate and Gift	13	13	14	15	15	16	17
Customs Duties	19	19	21	22	24	25	26
Miscellaneous	18	20	22	24	25	27	28
Total	1,153	1,251	1,338	1,411	1,479	1,556	1,630
On-budget	841	910	978	1,031	1,080	1,136	1,190
Off-budget[a]	312	341	360	380	399	420	440
			As a Percentage of GDP				
Individual Income	8.1	8.2	8.5	8.6	8.6	8.6	8.7
Corporate Income	1.9	1.9	1.9	1.8	1.8	1.8	1.7
Social Insurance	6.8	7.1	7.1	7.1	7.1	7.1	7.0
Excise	0.8	0.8	0.8	0.8	0.7	0.7	0.7
Estate and Gift	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Customs Duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Miscellaneous	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total	18.3	18.8	19.1	19.1	19.0	19.0	19.0
On-budget	13.4	13.7	14.0	14.0	13.9	13.9	13.8
Off-budget[a]	5.0	5.1	5.1	5.1	5.1	5.1	5.1

SOURCE: Congressional Budget Office.

a. Social Security.

taxes will be extended even if they are scheduled to expire (an assumption that is specified by the Balanced Budget Act). The current baseline thus assumes that three taxes will be extended: aviation taxes, Superfund taxes, and taxes levied to finance the cleanup of leaking underground storage tanks.

Four tax preferences that were extended by OBRA-93 will expire during 1994, and a fifth (the health insurance deduction for the self-employed) expired at the end of 1993. If the Congress extended all five preferences permanently, revenue in 1999 would be smaller by about $2.5 billion.

Eight other tax provisions are scheduled to expire between 1995 and 1998 (see Table 2-11). Extending the five that lose revenue would cost nearly $4 billion in 1999. Extending the other three would raise $1.6 billion in 1999.

Recent Trends in Tax Progressivity

On August 10, 1993, the President signed into law the Omnibus Budget Reconciliation Act of 1993. That act was the latest in a series of major changes in the federal tax laws. Since 1977, the Congress has enacted no fewer than eight major tax bills: the Revenue Act of 1978, the Economic Recovery Tax Act of 1981 (ERTA), the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the Deficit Reduction Act of 1984 (DEFRA), the Tax Reform Act of 1986 (TRA), the Omnibus Budget Reconciliation Act of 1989 (OBRA-89), the Omnibus Budget Reconciliation Act of 1990 (OBRA-90), and, most recently, OBRA-93. The Congress also passed the Social Security Amendments of 1977, which scheduled a series of increases in payroll tax rates that took place over the following decade, and the Social Security Amendments of 1983, which accelerated the effective dates of those increases and, for the first time, made a portion of Social Security benefits subject to the individual income tax.

These changes in the law have resulted in a very different tax structure today than before 1980. The income tax rate schedule is lower and flatter, and many tax preferences under the individual income tax have been tightened or eliminated. The top corporate tax rate is lower, but the investment tax credit has been repealed, and other business investment incentives, which were expanded in ERTA, were scaled back or eliminated by subsequent legislation. The base for payroll taxes is wider, and rates are higher. Some excise tax rates are higher today than they were a decade ago, partly offsetting the tendency of revenues from excise taxes to decline in real terms with inflation.

Despite these major changes, the distribution of federal taxes among income groups was nearly the same by the end of the 1980s as it was in 1977. When the latest changes from OBRA-90 and OBRA-93 are fully in place, however, the distribution of federal taxes will be more progressive than it was in 1977. This overall pattern is explained by two developments that tug in opposite directions. The individual income tax will be significantly more progressive, but the government has also come to rely more on social insurance taxes, a relatively regressive source.[6]

Greater Progressivity in Total Effective Tax Rates

One way to gauge tax progressivity is to compare the ratio of taxes paid to before-tax income for different family groups. This ratio is called the effective tax rate. A tax is progressive if the effective tax rate for groups with higher income is greater than the effective rate for groups with lower income.

To analyze the progressivity of the tax structure, CBO divides families into five groups by family income, with equal numbers of people in each group. In 1994, the effective tax rate--the combination of income, payroll, and excise taxes--is projected to range from 5.1 percent for the 20 percent of the population with the lowest income (the bottom quintile) to 27.7 percent for the 20 percent of families with the highest income (the top quintile).

6. A more detailed discussion of these topics will appear in a forthcoming CBO study.

Table 2-11.
Effect of Extending Tax Provisions That Have Recently Expired or Will Expire in 1994 Through 1999
(By fiscal year, in billions of dollars)

Tax Provision	Expiration Date	1994	1995	1996	1997	1998	1999
	Expired Provision						
Health Insurance Deduction for Self-Employed	12/31/93	-0.2	-0.5	-0.5	-0.6	-0.6	-0.7
	Provisions Expiring in 1994						
Generalized System of Preferences	9/30/94	n.a.	-0.5	-0.6	-0.6	-0.6	-0.7
Deduction for Contributions to Private Foundations	12/31/94	n.a.	a	a	a	a	a
Targeted Jobs Tax Credit	12/31/94	n.a.	-0.1	-0.2	-0.4	-0.4	-0.5
Exclusion for Employer-Provided Education Assistance	12/31/94	n.a.	-0.2	-0.5	-0.6	-0.6	-0.7
Orphan Drug Tax Credit	12/31/94	n.a.	a	a	a	a	a
	Provisions Expiring in 1995						
Denial of Deduction for Certain Noncomplying Health Plans	5/12/95	n.a.	-0.1	-0.1	-0.2	-0.2	-0.2
Research and Experimentation Credit	6/30/95	n.a.	-0.3	-1.0	-1.7	-2.1	-2.6
Allocation Rules for Research and Experimentation Credit	7/31/95	n.a.	-0.3	-0.6	-0.6	-0.6	-0.7
Fees for IRS Letter Rulings	9/30/95	n.a.	n.a.	b	b	b	b
Commercial Aviation Exemption from Transportation Fuels Tax	9/30/95	n.a.	n.a.	-0.4	-0.4	-0.4	-0.5
Corporate Tax Dedicated to Superfund	12/31/95	n.a.	n.a.	0.4	0.7	0.7	0.7
	Provision Expiring in 1996						
Nonconventional Fuels Credit for Fuel from Biomass and Coal	12/31/96	n.a.	n.a.	n.a.	a	a	a
	Provision Expiring in 1998						
FUTA Surtax of 0.2 Percentage Points	12/31/98	n.a.	n.a.	n.a.	n.a.	n.a.	0.9

SOURCE: Joint Committee on Taxation.

NOTES: No provisions are scheduled to expire in 1997, and the provisions expiring in 1999 do not expire until the end of the fiscal year. The list does not include expiring excise taxes that are assumed to be extended.

n.a. = not applicable; IRS = Internal Revenue Service; FUTA = Federal Unemployment Tax Act.

a. Loss of less than $50 million.

b. Increase of less than $50 million.

The sweeping revisions in tax laws that were enacted between 1977 and 1993 actually resulted in little change in either the overall levels or the distribution of effective tax rates by income groups between the beginning and the end of that 16-year span (see Figure 2-5). The major exception is the lowest income group. Once the changes enacted in OBRA-90 and OBRA-93 are fully in place, the effective tax rate for families in the lowest income quintile will be lower than in any year from 1977 to the present.

The level and distribution of effective tax rates did, however, shift in one direction and then back again during the intervening years. Federal taxes became less progressive between 1977 and 1985, as effective rates fell for high-income families and rose for low-income families. They then became more progressive, reversing the trend of the previous eight years.

For the most part, the pendulum had already swung back by 1990; in that year, effective tax rates for most family income groups were nearly the same as they had been for comparable families in 1977, except for families in the highest income group. Those families faced a total tax rate of 25.5 percent in 1990 versus 27.2 percent in 1977, with most of the decline concentrated in the top 1 percent of the income distribution. Several factors contributed to the fall in effective tax rates for these highest-income families. The top individual income marginal tax rate dropped from 70 percent in 1977 to 28 percent in 1990; the drop in the top marginal rate applicable to earned income and to capital gains, which had not been subject to the full 70 percent rate, was somewhat less. Effective corporate income tax rates (measured in relation to these families' total income) declined as taxable corporate profits grew more slowly than personal income.

But between 1990 and 1993, families at the top of the income scale were subjected to several tax increases. OBRA-90 set the top marginal income tax rate at 31 percent and limited the benefits from itemized deductions and personal exemptions for those families. Among other changes, OBRA-93 added new individual income tax rates of 36 percent and 39.6 percent and made all earnings subject to Medicare's Hospital Insurance (HI) payroll tax. (In 1993, earnings over $135,000 were shielded from that tax.) These changes will push the total effective tax rate for the highest-income families back near the rate for comparable families in 1977.

Greater Progressivity in Individual Income Tax Rates

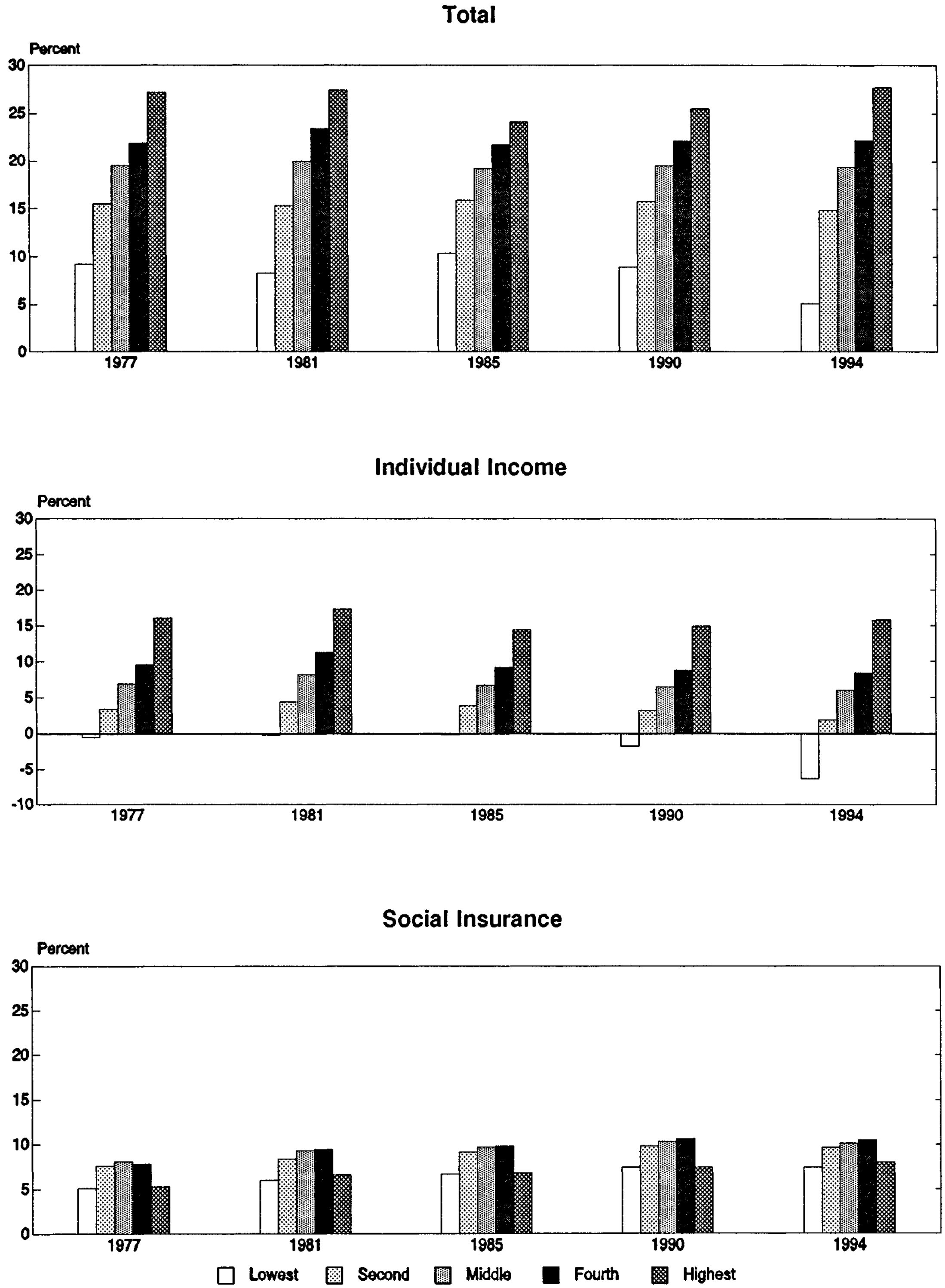
Total federal taxes became more progressive because of the trends in their leading component, individual income taxes. Nearly half of all federal revenues come from individual income taxes. Social insurance payroll taxes now account for more than one-third, corporate income taxes for about 10 percent, and excise taxes for less than 5 percent of revenues. The remaining revenues come from estate and gift taxes, customs duties, and other miscellaneous receipts.

Viewed in isolation, individual income taxes will be more progressive than they were in 1977 once the changes enacted in OBRA-90 and OBRA-93 are fully implemented, largely because of an expanded earned income tax credit. The EITC is a refundable credit available to low-income working families. Although the refundable portion of the credit is counted as an outlay in the federal budget, it nevertheless stems from provisions of the tax code and is thus treated in distributional analyses as a feature of the individual income tax system. OBRA-90 greatly increased the amount of the credit, as did OBRA-93; and the 1993 expansion for the first time made low-income workers without children eligible for a small credit.

Average effective individual income tax rates were lower for families in all income quintiles in 1990 than for comparable families in 1977. In fact, effective individual income tax rates became significantly less than zero for families in the lowest income quintile for the first time in 1990 because of the liberalizations in the EITC; that is, the average family in the lowest quintile received payments from the government under the individual income tax.

Once all of the changes from OBRA-90 and OBRA-93 are in place, effective individual income tax rates will still be lower for families in the four lower income quintiles than in 1977 but will have returned to 1977 levels for the top quintile. And the

Figure 2-5.
Effective Federal Tax Rates in Selected Years, 1977-1994, by Income Group



SOURCE: Congressional Budget Office.

NOTE: Families are ranked by adjusted family income, with an equal number of people per quintile. Rates for 1994 are projected using the fully implemented rates for the earned income tax credit set in the Omnibus Budget Reconciliation Act of 1993.

effective subsidy received by families in the lowest income quintile will be about 10 times as big as the subsidy received by comparable families in 1977.

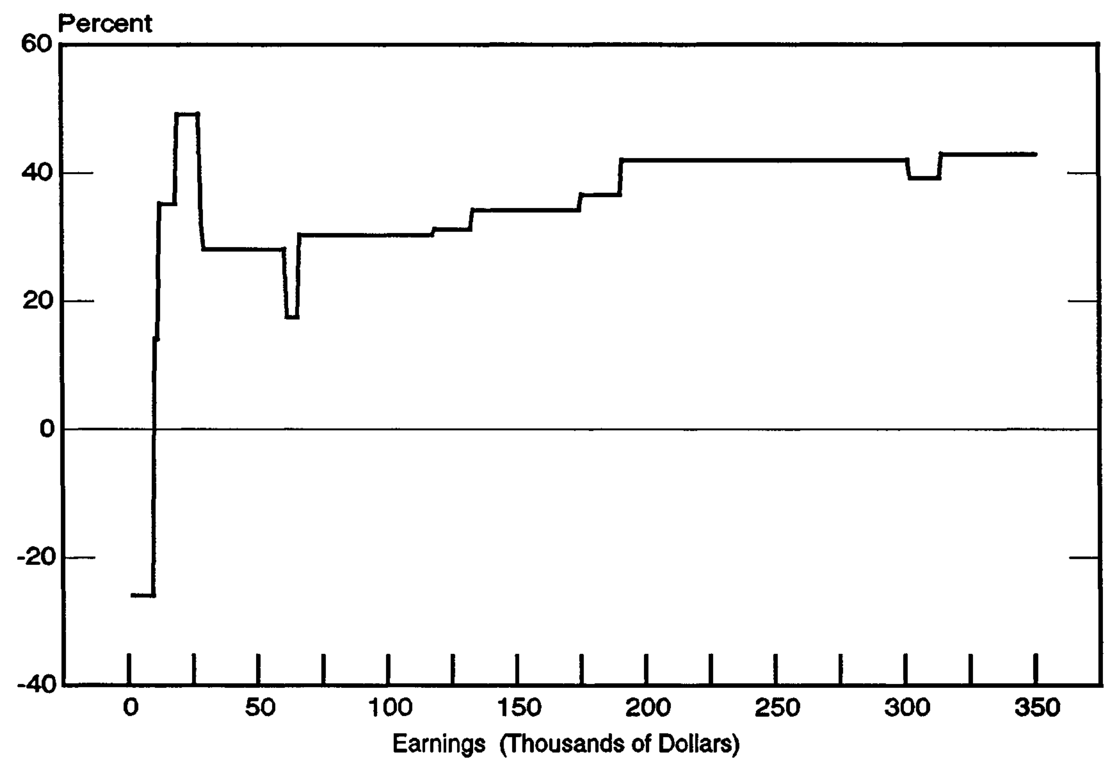
Greater Reliance on Payroll Taxes

Total federal taxes might have become even more progressive if payroll taxes for social insurance had not grown in importance as a source of federal revenues. They will account for an estimated 37 percent of federal revenue in 1994, up from 30 percent in 1977. Payroll taxes are less progressive than federal income taxes; effective federal payroll tax rates are progressive only at the lowest end of the income distribution, virtually flat across the three middle income quintiles, and regressive at the top (see the bottom panel of Figure 2-5). Although payroll taxes did become more progressive between 1977 and 1994--mainly because the ceiling on wages subject to the Social Security and Medicare taxes was steadily lifted (and ultimately, in the case of Medicare, repealed)--payroll taxes remain much less progressive than income taxes. Hence, their increasing weight in the revenue totals has dampened the overall move toward greater progressivity.

Marginal Tax Rates After OBRA-93

With the enactment of OBRA-93, marginal tax rates on earnings--the fraction of the last dollar of earnings

Figure 2-6.
Marginal Tax Rate on Earnings in 1994, Including Payroll and Income Taxes, for a One-Earner Couple with Two Children



SOURCE: Congressional Budget Office.

NOTE: All calculations use 1994 tax law except for the earned income tax credit, which is at 1996 levels. The estimates assume that all income is from self-employment and that the taxpayer has deductions equal to the greater of the standard deduction or 20 percent of earnings.

paid in taxes--will range from a subsidy of 26 percent to a tax of 49 percent when both individual income taxes and payroll taxes are taken into account (see Figure 2-6).

Taxpayers with the highest income will face marginal tax rates of nearly 43 percent. This rate is lower than the 50 percent top rate on earnings in 1977. As recently as 1990, however, the highest income tax bracket was 28 percent, and high-income taxpayers were not subject to further payroll taxes as their income rose. OBRA-93 added a 39.6 percent bracket to the individual income tax. When the limitation on itemized deductions, which was made permanent by OBRA-93, is taken into account, the top income tax rate reaches 40.8 percent. Furthermore, all earnings are now subject to Medicare's HI payroll tax of 1.45 percent paid by both employers and employees. Because the employer share of the payroll tax is deductible, the extension of the HI tax to high-income workers adds another 2.1 percentage points to the top tax rate.

The workers facing the highest marginal tax rates are those whose earnings are in the range in which the EITC disappears--essentially, in the low $20,000 range for a couple with two children. Such families lose about 21 cents of EITC payments for every dollar of additional earnings. Added to the 15 percent individual income tax and the Social Security payroll tax of 7.65 percent on both employees and employers, the total marginal tax rate on these families is just over 49 percent when interactions between the taxes are taken into account.

Very low income workers with children are subsidized by the federal government. These workers are exempt from the regular income tax; and for workers with at least two children, the EITC is increased by 40 cents for each additional dollar of earnings up to $8,425. This subsidy more than offsets the additional payroll taxes they owe, and their marginal tax rate is negative.